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assumption that these negotiated rates "were certainly not set by the parties without reference to the cost of service to be provided," negotiated prices could be expected to yield rates that approximate cost-based rates only if they were negotiated at arm's length by parties having equal bargaining power. That was clearly not the case in the negotiations between BellSouth, an entrenched monopolist, and AT&T; AT&T has nothing that BellSouth wants, and has no alternative supplier to BellSouth. Nor was it likely to have been the case in negotiations between BellSouth and ACSI, a much smaller carrier seeking to establish a competitive niche in BellSouth's local exchange market.

**D. The Tariffed Rates Are Not Cost-Based Under TELRIC Principles.**

34. The rates that form the basis of certain of BellSouth's proposed interim interconnection/UNE prices insofar as they are derived from intrastate and interstate tariffs are also not cost-based as required by the Act. Section 252(d)(1)(A) of the Act clearly provides that the cost basis of determinations that rates are just and reasonable shall be made "without reference to a rate-of-return or other rate-based proceeding." 47 U.S.C.

§ 252(d)(1)(A). BellSouth's proposed interim rates, to the extent they are based upon intrastate tariffs, were clearly made with reference to "rate-of-return or other rate-based proceeding[s]." As such, they do not conform to the express requirements of the Act.

BellSouth conceded in cross-examination before the SCPSC in the South Carolina Section 271 proceeding that the intrastate rates proposed in BellSouth's price list were from an era

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during which BellSouth was governed by a rate-of-return regime. Tr. of hearings July 8, 1997 at 137.<sup>6</sup> As to the interstate tariff which provides the basis for the virtual collocation rates -- in particular, FCC No. 1 -- many of those rates significantly exceed the costs computed in BellSouth's own cost studies. For example, BellSouth's tariff imposes a \$0.0003 common transport per query charge for BellSouth's LIDB database. BellSouth cost studies computed a charge for this same service of \$0.00008. See Scheye Exhibit RCS-3 (SCPSC Docket No. 96-358-C). Not surprisingly, the higher tariff charge is the charge reflected in BellSouth's SGAT. Moreover, certain of the interim rates proposed by BellSouth that are derived from existing interstate and intrastate tariffs are not subject to true-up. Hence, whatever protection a true-up mechanism provides -- and, as I will explain below, it is of minimal value -- it is completely absent in the case of the tariff rates.

**E. BellSouth's Reliance on the Commission's Proxy Rates Is Misplaced.**

35. In its application, BellSouth claims that its UNE rates are within the proxy ranges prescribed in the Local Competition Order. The SCPSC has also cited the proxy ranges in its approval of BellSouth's application. But the proxy ranges cannot support a

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<sup>6</sup> That regime was not superseded by the so-called Consumer Price Protection Plan, intended to regulate prices rather than earnings, until after January 30, 1996. See Re BellSouth, 169 P.U.R. 4th 144, 1996 WL 303777 (S.C.P.S.C.).

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finding that BellSouth's UNE rates comply with the Act, particularly under the circumstances here.

36. As a preliminary matter, the BellSouth loop rate exceeds the Commission's proxy for South Carolina by more than 5% (\$18.00 versus \$17.07). More fundamentally, as the Commission acknowledged in the Local Competition Order, the proxy ranges do not reflect forward-looking costs in South Carolina, but were based on the best information then available to the Commission. The proxy ranges were intended for use solely for an interim period to give the parties an opportunity to prepare appropriate cost studies. AT&T has since proposed UNE rates to the SCPSC, based on the Hatfield Model, which comply with all of the TELRIC principles. More than 14 months have elapsed since the Commission released its Local Competition Order. BellSouth has had ample opportunity to submit its own TELRIC-compliant cost studies to the SCPSC, and to the Commission. In these circumstances, the Commission should decline to find that BellSouth's rates comply with the Act based on the proxy ranges.<sup>7</sup>

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<sup>7</sup> In all events, the Commission did not adopt "proxy ranges" for non-recurring charges. Moreover, as noted above, BellSouth submitted no cost studies for such charges, TELRIC or otherwise, to the SCPSC in either the arbitration proceeding or the Section 271 proceeding.

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F. That BellSouth's Interim Rates Are Subject to True-Up and Are Capped at Existing Levels Retroactively Does Not Render Such Rates Cost-Based.

37. The SCPSC also appears to believe that the interim rates it has approved are somehow cost-based because they are subject to true-up once permanent rates are determined to be just and reasonable on the basis of appropriate cost evidence. This belief is clearly mistaken. The issue in this proceeding is whether there are presently sufficient bases for competition in BellSouth's local exchange market that BellSouth should be permitted to enter long distance markets. As the Commission made clear in the Ameritech Michigan Order

[A] BOC's promises of future performance . . . have no probative value in demonstrating its present compliance with the requirements of Section 271. . . . In order to gain in-region, interLATA entry, a BOC must support its application with actual evidence demonstrating its present compliance with the statutory conditions for entry . . . .

Id. at ¶ 55. Hence, as the competitive checklist of Section 271 of the Act itself makes clear, the prices presently being charged for interconnection, UNEs and reciprocal compensation must be cost-based. That these prices may be changed retroactively at some future time by means of a true-up mechanism is simply irrelevant to the Section 271 inquiry.

38. As a practical matter, moreover, the possibility that a state commission may adopt lower rates in the future in a "permanent" cost proceeding, and that a "true-up"

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mechanism would then be invoked, will not stimulate entry by CLECs. By its terms, the true-up mechanism depends entirely on a decision adopting permanent rates that are lower than the interim rates. It is at best speculative that such a decision will ever be issued. In South Carolina, moreover, there is even greater uncertainty than elsewhere, because the rates proposed by BellSouth in pending state proceedings to establish permanent rates are even higher than the interim rates, and as BellSouth admits, do not comply with TELRIC principles.

IV. **BELLSOUTH'S PROPOSED PERMANENT UNE RATES IN SOUTH CAROLINA LIKEWISE DO NOT COMPLY WITH TELRIC PRINCIPLES, AND ARE EVEN HIGHER THAN ITS UNLAWFUL INTERIM RATES.**

39. In the AT&T-BellSouth arbitration proceeding conducted by the SCPSC, BellSouth testified that it intended to prepare and submit in the permanent rate docket to be opened by the SCPSC new cost studies that would be based on its embedded costs, and did not otherwise reflect TELRIC principles:

BellSouth will initiate new or revised studies that will reflect all appropriate costs, including embedded costs and actual network architecture, i.e., studies that do not have the same infirmities as the FCC's defined TELRIC methodology.

Scheye Direct Testimony in SCPSC Docket No. 96-358-C at 13-14 (emphasis added).

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40. The SCPSC has since opened a proceeding to establish permanent UNE rates, and BellSouth has submitted new cost studies to support those rates. Although BellSouth is not scheduled to present its proposed prices until November 3, 1997, BellSouth's cost studies produce results that would support prices substantially higher than the rates included in its SGAT. For example, the monthly recurring rate for a two-wire analog voice grade loop is shown in BellSouth's SGAT as \$18.00 (excluding the network interface device which is separately priced at \$.53), and the associated non-recurring rate is shown as \$51.20. The monthly recurring cost for two-wire voice grade loop in South Carolina at the lowest available service level (service level 1) now computed by BellSouth is \$29.47 (as opposed to \$18.53), and the associated non-recurring charge is \$75.75 (as opposed to \$51.20). Similarly, for the monthly recurring cost for a two-wire analog line port which is shown as \$2.70 in BellSouth's SGAT, BellSouth now calculates a monthly recurring charge of \$3.93.

41. In addition, if BellSouth's permanent price proposals are based upon the cost computations that BellSouth has filed with the SCPSC, and I fully expect that they will be based on these computations, such price proposals will reflect BellSouth's most obvious and dramatic departure from TELRIC principles. BellSouth has proposed in each state in which permanent prices are to be set, as it will presumably propose in South Carolina, an explicit embedded cost recovery component, the Residual Recovery Requirement ("RRR"), to be added to the purported TELRIC costs developed by BellSouth for local loop and switch port

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elements. In fact, the RRR is nothing but an accounting "plug" that would ensure that all of BellSouth's historic costs will be recovered -- i.e., ensure that BellSouth is "made whole," even though it is not regulated under a rate base/rate of return regime, and effectively render moot all of BellSouth's loop and switch port cost studies allegedly based on TELRIC. To the extent that a state PSC were to find a BellSouth proposed rate excessive on the basis of TELRIC, to that same extent, BellSouth would increase its RRR.

42. Moreover, quite apart from this embedded cost add-on, BellSouth's cost studies reflect significant costs that would not be forward-looking. The increases in BellSouth's proposed loop charges, for example, are only attributable in part to the RRR add-on.<sup>8</sup> Although BellSouth witnesses have typically purported to embrace the principle that costs should reflect forward-looking network architecture, engineering, and materials and equipment, BellSouth's cost studies clearly violate this principle because they are based in large part on embedded characteristics of BellSouth's local network.

43. For example, in addition to the flaws that I noted earlier, BellSouth's loop cost study is based on a sample of embedded loops instead of a local network designed to connect

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<sup>8</sup> For example, for the basic two-wire voice grade loop, the proposed RRR cost add-on is \$3.38. Hence, even disregarding the add-on, if BellSouth's latest cost study for South Carolina proves to be the basis for its proposed rates, as it is certainly likely to, BellSouth's proposed charge for this UNE will have gone from \$18.53 to \$26.09.

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customers to existing wire centers using the most efficient technology available. See Local Competition Order at ¶ 685. Although BellSouth would argue that it has somehow "redesigned" certain characteristics of the sampled loops, its methodology ignores the fact that what BellSouth has done historically is not useful as an indicator of what an efficient carrier should do going forward in light of changes in: (1) technologies; (2) the relative costs of intersubstitutable assets; and (3) the regulatory environment. To capture these changes, it is necessary first to identify the relevant demographic and geographic characteristics of the areas being studied, and then, by applying accepted engineering practices, to design the forward-looking network needed to provide the relevant UNEs.

44. Moreover, BellSouth has based its cost studies on a short run, rather than long run, time horizon. For example, in computing non-recurring costs for Operation Support Systems ("OSS"), BellSouth has assumed extensive manual processes that should, even by now, have been displaced by electronic processes. If such studies are to be performed correctly, they must assume investment in forward-looking, efficient systems and labor expenses that would be incurred with such systems in place -- i.e., inefficient and labor-intensive processes that result from obsolete equipment are embedded characteristics that are not properly included in non-recurring cost studies. BellSouth's non-recurring cost studies completely violate these principles by assuming manual intervention in processes that should be almost entirely electronic (or "mechanized"). Moreover, they assume "fallout" rates for



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such mechanized processes requiring manual intervention rates that are completely unreasonable and that would provide BellSouth with little incentive to develop and invest in more effective and efficient systems.<sup>9</sup>

45. BellSouth's cost models also fail to apply forward-looking assumptions to the determination of shared and common costs. Rather than undertake to determine what an efficient level of shared and common costs should be going forward, BellSouth has based its shared and common cost calculations on already outdated historic accounting costs (subject to minor adjustments) and simply assumed without any justification that these historic costs are representative of those that would be incurred by an efficient carrier in the future. Clearly, with the significant changes that are being wrought in the local exchange industry, no such assumption is warranted.

46. Finally (at least for illustrative purposes), several of the most crucial inputs to BellSouth's cost studies -- depreciation lives and fill factor -- result in overstated costs.

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<sup>9</sup> BellSouth would now impose in South Carolina a \$10.90 non-recurring charge for OSS electronic orders apparently to recover system development costs from AT&T and other CLECs. If the SCPSC were to approve this imposition on CLECs of all of the costs of the electronic gateway capabilities that do not even allow CLECs the same operation support functions available today to BellSouth, CLECs would be at a significant cost disadvantage relative to BellSouth and would be paying higher, discriminatory rates for those same facilities.

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47. The depreciation lives underlying BellSouth's cost studies significantly inflate their results. The proper benchmark for depreciation lives are the projection lives underlying the depreciation rates prescribed by the Commission. These lives are forward-looking, state specific and based on extensive statistical analyses. See Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Third Report and Order released May 4, 1995 at ¶ 11. The lives used by BellSouth are not only regional lives, rather than state specific lives, but they are also lives that are intended for financial accounting purposes. As this Commission has found, financial accounting purposes entail a conservative bias that may be inappropriate for regulatory purposes. See id., First Report and Order released October 20, 1993 at ¶ 46. In view of these considerations, and in view of the fact that the depreciation lives used by BellSouth are significantly shorter than those underlying the Commission's prescribed depreciation rates, BellSouth's lives are inherently suspect.

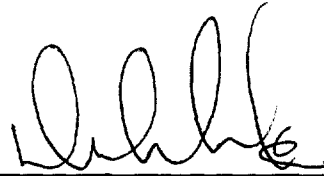
48. The BellSouth cost studies also fail to correctly match assumptions regarding investments and demand and therefore apply understated fill factors (or overstated spare capacity) and significantly overstate costs. BellSouth's cost studies include spare capacity placed not merely to serve all current customers in a particular area but also all expected future customers. As a result, BellSouth would in effect require new entrants to pay for BellSouth investment needed to serve both current and future customers. Hence, BellSouth's

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costs to serve customers in the future will be paid for by its current competitors, and  
BellSouth will be able to over-recover its costs and erect a significant barrier to entry.

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Don J. Wood, having been sworn in accordance with law, hereby deposes and states that he has read the foregoing affidavit and attachments and that the contents thereof are true and correct to the best of his knowledge and belief.



DON J. WOOD

Signed and Sworn to before me this 14 day of October, 1997.



NOTARY PUBLIC

My Commission Expires:

March 19, 2001

Notary Public, Fulton County, Georgia  
My Commission Expires March 19, 2001

**Notary Public, Fulton County, Georgia**  
**My Commission Expires March 19, 2001**